Supreme Court, U. S.
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IN THE

Supreme Court of the United States

October Term, 1977

No. 77-412

BRUCE COMPTON and
D. W. GODFREY,

Petitioners

vs.

McCOOK COUNTY NATIONAL
BANK, a corporation,

Respondent

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

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O'CONNOR PRINTERS — SIOUX FALLS, S. DAK.

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The Petitioners pray that a Writ of Certiorari issue to review the Judgment of the United States Court of Appeals for the Eighth Circuit entered in the above case on June 17, 1977.

OPINIONS BELOW

The opinion of the District Court for the Southern District of South Dakota (R 24) was not officially reported. It was rendered on July 19, 1976 and Judgment pursuant thereto was entered on August 4, 1976. The opinion of the Court of Appeals for the Eighth Circuit has not yet been officially reported. Copies of both opinions are appended hereto.

JURISDICTION

The decision of the Court of Appeals for the Eighth Circuit was made and entered on June 17, 1977. The jurisdiction of this Court is invoked under 28 U.S.C. 2101(c).

QUESTIONS PRESENTED

The District Court found in its Memorandum Decision that the respondent in this case did not take the instrument in question, a check in the amount of $13,340, as a holder in due course. Specifically, the District Court held that the respondent did not take the instrument without notice of any defense or claim to it on the part of any person and, additionally, although not deciding specifically on this issue, found that substantial questions as to the respondent's good faith had been raised.

The Eighth Circuit Court of Appeals, upon its review, disagreed with the District Court and reversed that Judgment. It held that there was not notice to the respondent and thus it did take the instrument in good faith and without notice that it was overdue or had been dishonored or of any defense against or claim to it on the part of any person.

The questions presented are:

1. Whether the respondent took the instrument with or without notice of any defense or claim to it on the part of any person.

2. Whether the respondent took the instrument in good faith.

STATUTES INVOLVED

The pertinent statutes are recited below (SDCL refers to South Dakota Codified Laws): SDCL 57-1-7 (UCC 1-201(25)), Vol. 15, p. 564; SDCL 57-1-8 (UCC 1-201(26)), Vol. 15, p. 564; SDCL 57-1-9 (UCC 1-201(27)), Vol. 15, p. 565; SDCL 57-12-2 (UCC 3-302(1)), Vol. 15, pp. 696-697; SDCL 57-12-9 (UCC 3-304(1)(a)), Vol. 15, p. 700; SDCL 57-12-15 (UCC 3-304), Vol. 15, p. 703 and SDCL 57-12-18 (UCC 3-306), Vol. 15, p. 705.

57-1-7. "Notice" of a fact — Acts constituting. — In this title, unless the context otherwise requires, a person has "notice" of a fact when

(1) He has actual knowledge of it; or

(2) He has received a notice or notification of it; or

(3) From all the facts and circumstances known to him at the time in question he has reason to know that it exists. A person "knows" or has "knowledge" of a fact when he has actual knowledge of it. "Discover" or "learn" or a word or phrase of similar import refers to knowledge rather than to reason to know. The time and circumstances under which a notice or notification may cease to be effective are not determined by this title.

57-1-8. Notification of another — Acts constituting. — In this title, unless the context otherwise requires, a person "notifies" or "gives" a notice of notification to another by taking such steps as may be reasonably required to inform the other in ordinary course whether or not such other actually comes to know of it. A person "receives" a notice or notification when

(1) It comes to his attention; or

(2) It is duly delivered at the place of business through which the contract was made or at any other place held out by him as the place for receipt of such communications.

57-1-9. Notice to organization — Time effective — Routines for communication — Due diligence of individual acting for organization. — In this title, unless the context otherwise requires, notice, knowledge or a notice or notification received by an organization is effective for a particular transaction from the time when it is brought to the attention of the individual conducting that transaction, and in any event from the time when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there

is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information.

57-12-2. Holder in due course defined. — A holder in due course is a holder who takes the instrument

(1) For value; and

(2) In good faith; and

(3) Without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person; and

(4) The instrument is not consumer paper as described in chapter 57-10A.

57-12-9. Claim or defense — Notice to purchaser — Incomplete instrument — Visible evidence of alteration — Ambiguity as to party to pay. — The purchaser has notice of a claim or defense if the instrument is so incomplete, bears such visible evidence of forgery or alteration, or is otherwise so irregular as to call into question its validity, terms or ownership or to create an ambiguity as to the party to pay.

57-12-15. Claim or defense — Effective notice, reasonable opportunity for action. — To be effective notice must be received at such time and in such manner as to give a reasonable opportunity to act on it.

57-12-18. Rights of one not a holder in due course. — Unless he has the rights of a holder in due course any person takes the instrument subject to

(1) All valid claims to it on the part of any person; and

(2) All defenses of any party which would be available in an action on a simple contract; and

(3) The defenses of want or failure of consideration, nonperformance of any condition precedent, nondelivery, or delivery for a special purpose. (57-13-17); and

(4) The defense that he or a person through whom he holds

the instrument acquired it by theft, or that payment or satisfaction to such holder would be inconsistent with the terms of a restrictive endorsement. The claim of any third person to the instrument is not otherwise available as a defense to any party liable thereon unless the third person himself defends the action for such party.

STATEMENT

On February 3, 1975, a Monday morning, Mrs. Dean Tabke of rural route Canistota, South Dakota, presented to Harvey Eichinger, Senior Vice President of the respondent bank in Salem, South Dakota, a check already endorsed, with a $10,000 discrepancy on the face of it, made payable to her husband's feeding business account and endorsed in full settlement of said business account. Mr. Eichinger was requested to cash the check and issue six bank money orders from a list of creditors, obvious to be feedlot creditors from the list itself (R. 57-58). The Tabkes were noncustomers of Mr. Eichinger's bank; in fact, Mr. Eichinger knew that they banked at United National Bank in Canistota (R. 39). The check was drawn on the petitioners' account at the Northwestern National Bank in Sioux City, Iowa.

Repondent's bank has a previous banking history with the Tabkes, in that it had purchased Dean Tabke's farm implement-dealer paper. Mr. Eichinger knew that Dean Tabke was sometimes delinquent in his farm implement-dealer payments and that they periodically had to be extended as to maturity dates. In fact, Dean Tabke had contacted Mr. Eichinger sometime in the fall of 1974, about three months prior to the transaction at issue herein, relative to a loan and possibly moving his business to Mr. Eichinger's bank (R. 32-36). Mr. Eichinger further knew that the Tabkes lived one mile from their own bank and some eight or ten miles from his bank (R. 34, 44). Furthermore, the check was not drawn on Mr. Eichinger's bank, but in fact on a bank in Sioux City, Iowa. Dean Tabke, whose name appeared on the

endorsement on the back of the check, did not accompany his wife to Mr. Eichinger's bank the morning she presented the check for payment (R. 44).

Moreover, Mr. Eichinger's bank was a subscriber to the McCook County Credit Reporting Service, an official publication prepared by the Register of Deeds office in Salem, (Salem is the county seat of McCook County, the county in which the Tabkes lived and the county where both the respondent bank and the United National Bank, its competitor, are located). It was a function of that service to officially report UCC filed documents. Because of their subscription to that service, Mr. Eichinger's bank had actual notice of another bank's (United National Bank of Canistota) security interest in Dean Tabke's cattle, machinery, inventory, accounts and contract rights. Mr. Eichinger himself had previously read the Reports in question (R. 37-39; 55-57). Notwithstanding all of the above, he complied with Mrs. Tabke's request on said Monday morning, February 3, 1975, and in fact cashed the check after a mere phone call to Sioux City that simply verified amount and account balance as of that moment. Mr. Eichinger issued the six bank money orders for the nominal consideration of $6.00 (R. 51). Just minutes after the cashing of the check and issuance of the bank money orders, Mrs. Tabke had a brief conversation with Mr. Eichinger in the bank lobby while she still had the six bank money orders in her possession. She informed Mr. Eichinger that she was cutting the check at Salem rather than their bank at Canistota because her husband felt that proceeds should go to general creditors as opposed to the United National Bank of Canistota as a secured creditor (R. 62-63). Later that same day Mr. Eichinger denied to an officer of United National Bank that the Tabke's had been channeling funds through his bank (R. 68-69).

United National Bank, a secured creditor, learned of this "check cutting" the next day and prevailed upon the drawers of the check, the petitioners, to stop payment, because the

cashing of the check and the reissuance into six bank money orders represented unauthorized preferential treatment of unsecured creditors to its material detriment. The respondent, a South Dakota bank, then brought suit for the value of the check ($13,340.00) against the petitioners, who are both residents of Iowa, in Federal District Court for the Southern District of South Dakota. Pursuant to SDCL 57-12-18(4) (UCC 3-306(4)), the United National Bank of Canistota defended the petitioners throughout the course of litigation.

REASONS FOR GRANTING THE WRIT

The decision of the Eighth Circuit Court of Appeals should be reviewed because it erroneously interprets the notice provision with respect to holder in due course, particularly in light of a case cited by that Court, *Morgan Guaranty Trust Company of New York v. Third National Bank of Hampden County* reported in 400 F. Supp. 83 (D. Mass. 1975), and affirmed in 529 F. 2d 1141 (1976). The *Morgan* case interprets the notice provision of UCC 3-302, SDCL 57-12-2.

The decision against the petitioners directly conflicts with the decision of the Circuit Court of Appeals in *Morgan*. In both cases facts were presented which should have consistently resulted in denial of holder in due course status. The Eighth Circuit Court of Appeals attempted to distinguish the *Morgan* case on the basis that the list of stolen securities was specifically sent to the Third National Bank of Hampden County, they received the same and utilized this list in discovering stolen securities. The Eighth Circuit Court of Appeals states, at page 6 that:

> United bank did not give a specific notice to McCook bank of their security interests in Tabke's accounts receivable. Inclusion of Tabke's agreement in summary form in the general report in the Register of Deeds commercial reporting services is not the same as a *specific notice* sent *directly* to a bank from a secured party. (Emphasis is original)

Admittedly, it is hard for a court in St. Louis, Missouri to conceive of a small, sparsely populated agricultural county in

eastern South Dakota, but that is the situation that must be considered to properly decide this case. In fact, this case does not deal with a list of stolen securities distributed by Morgan Guaranty Trust Company in New York to hundreds of banks, financial institutions and brokers on the eastern seaboard; rather it deals with a situation where the population of the entire county is 5,000 people or less! What may not constitute notice to a banker in St. Louis or New York City could well constitute notice to a rural banker in Salem, McCook County, South Dakota. This is particularly true when it is remembered that the banker testified that he personally knew the Tabkes (R. 32-36), that they had been former customers of his bank and that in fact he knew that they banked elsewhere within his county (R. 39, 44). We respectfully submit that this is the same as a specific notice sent directly to the bank from the secured party when considered in this context. The Eighth Circuit Court of Appeals has decided directly in contravention of the *Morgan* case.

Additionally, the Eighth Circuit Court of Appeals did not correctly interpret the notice requirements as contained in SDCL 57-1-7, 8 and 9, (UCC 1-201(25, 26 and 29)), in light of the following facts: United National Bank (having a claim to the instrument and defending the action for petitioners' Compton and Godfrey) was a perfected, secured creditor of Dean Tabke's feedlot business; the Tabkes were customers of United National Bank well known to Harvey Eichinger, officer of respondent bank; respondent bank subscribed to and Harvey Eichinger testified that he had read the reports of the Commercial Credit Reporting Service of the McCook County Register of Deeds office which clearly reflect that United National Bank held a perfected security interest in all of Dean Tabke's collateral relative to his farm and feedlot operation; while Mrs. Tabke was still in the bank with the six bank money orders in her hand she specifically stated to Mr. Eichinger two things:

1. That the six bank money orders were going to general creditors other than the United National Bank, a secured creditor, and

2. That her husband, Dean, felt that this was right and that possibly they would be doing business with Harvey Eichinger in the future.

Furthermore, the instrument itself, with all of the discrepancies on the face of it, would put any prudent banker on notice particularly when presented by a non-customer; Harvey Eichinger knew that the Tabkes did not bank in his town but banked at United National Bank some eight miles away; later in the day in question Harvey Eichinger denied over the phone to a collection officer of United National Bank that neither of the Tabkes had been in his bank on that day on any sort of bank business (which certainly raises serious questions as to good faith). The cumulative effect of all of the above facts is to put any prudent banker on notice of the claim of United National Bank and also indicates that the principal officer involved, Harvey Eichinger, did not display good faith in his actings and dealings. Certainly Harvey Eichinger, from all the facts and circumstances known to him at the time in question, had notice of the prior secured claim of United National Bank. SDCL 57-1-7 (UCC 1-201(25)) does not specify from which source notice must come. Notice may be imputed through a variety of circumstances and certainly the facts as just outlined indicate that from the sources available to Harvey Eichinger, he did have notice.

Finally, this petition would be remiss if it did not speak to the Eighth Circuit Court of Appeals' failure to find notice in Mrs. Tabke's lobby conversation with Mr. Eichinger. Specifically, while Mrs. Tabke was still in the bank with the six bank money orders in her hand, she personally informed Harvey Eichinger that the proceeds were going to general creditors other than United National Bank, a secured creditor, because her husband felt that this was right. The Circuit Court attempted to distinguish this by citing SDCL 57-12-15 (UCC 3-304), and conveniently noting that simply

because the conversation took place after the check had been cashed, but while Mrs. Tabke was still in the bank, that it was too late to do anything. Petitioners respectfully submit that all Harvey Eichinger had to do was simply inform Mrs. Tabke that, in light of her remarks, the proceeds of those six bank money orders were not going to the proper creditors and that if she didn't hand them back over in re-exchange for her check that he would simply have no alternative but to place a stop order on the money orders. This is a very simple solution to a very simple problem and it is hard to conceive why the Circuit Court did not consider this.

Petitioners feel that it is particularly meaningful to note the final utterances of the Circuit Court. Although it appears that the Circuit Court felt the respondent had notice of the claims of United National Bank on the instrument, it could not force itself to so hold as is patently indicated on p. 13 of its opinion:

> In sum, while a better judgment concerning the negotiability of the check *might* have been made we can not find the requisite notice or bad faith that would deprive McCook bank of its status as holder in due course. (Emphasis is original)

CONCLUSION

For the reasons set forth above, it is respectfully submitted that this Petition for Writ of Certiorari should be granted and that the Judgment of the Court of Appeals be reversed.

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STATE OF SOUTH DAKOTA)
:SS
COUNTY OF MINNEHAHA)

AFFIDAVIT OF SERVICE

ROBERT J. McDOWELL, after being first duly sworn upon his oath states and alleges:

That I am one of the attorneys for the Petitioners in the above entitled case; that in compliance with United States Supreme Court Rule 33 3(c) I have this date served upon E. Steeves Smith, of the law firm of Tinan, Carlson, Padrnos & Smith at P.O. Box 488, 204 Johnson Building, Mitchell, South Dakota, 57301, one of the attorneys for the Respondents, three printed copies of the within Petition for Writ of Certiorari; that with such service, all parties required have been served.

Dated at Sioux Falls, South Dakota, this 13th day of September, 1977.

ROBERT J. McDOWELL

Subscribed and sworn to before me
this 13th day of September, 1977.
SANDRA M. PARSONS
NOTARY PUBLIC — SOUTH DAKOTA
My commission expires: 6/6/83

MEMORANDUM DECISION
(Filed July 19, 1976)

Mr. E. Steeves Smith of Tinan, Carlson, Padrnos & Smith, of Mitchell, South Dakota, appeared in behalf of the plaintiff;

and

Mr. Robert J. McDowell of Boyce, Murphy, McDowell & Greenfield, of Sioux Falls, South Dakota, appeared in behalf of the defendants.

This action arises from a transaction in which plaintiff McCook County National Bank cashed a check, drawn by defendant Compton and signed by defendant Godfrey, for Mrs. Dean Tabke. Defendants subsequently stopped payment on the check, and plaintiff sues as collecting bank and holder in due course. This court has jurisdiction pursuant to 28 U.S.C. section 1332, as there is diversity of citizenship and the amount of the check involved exceeds $10,000.

The case was tried to the court without a jury. After a thorough review of the evidence presented, the court has determined that its verdict must be in favor of defendants Compton and Godfrey. This memorandum decision respresents the court's findings of fact and conclusions of law pursuant to Fed. R. Civ. P. 52(a).

The facts show that defendant Compton had a contract with Dean Tabke under which Tabke fed cattle belonging to Compton, for which Tabke was to be compensated based upon the weight gain of the cattle. On February 2, 1975, Tabke met with the defendants and it was determined that he was entitled to a payment of $13,430. A check, drawn on the Northwestern National Bank of Sioux City, Iowa, was issued to Dean Tabke in the amount of $13,430. This amount was properly entered on the check by hand, but defendant Godfrey, an employee of Compton's, mistakenly entered the amount of $3,430 with a check imprinter.

The check indicated that it was "In Full Settlement of Feeding Contract," and Dean Tabke endorsed it as "Dean

Tabke, Beef Lodge." Tabke then instructed his wife to cash the check at plaintiff Bank and obtain six cashier's checks made out to various creditors, which Mrs. Tabke did on the morning of February 3, 1975.

When Mrs. Tabke cashed the check, she spoke to Mr. Eichinger, the managing officer of plaintiff Bank, and pointed up the discrepancy between the hand written and printed amounts on the check. Eichinger called the Northwestern National Bank in Sioux City and was informed that the check was "okay." Mrs. Tabke was then allowed to cash the check and purchase six money orders from one of plaintiff Bank's tellers. After the check had been cashed, Mrs. Tabke again spoke with Mr. Eichinger and made some remark to the effect that she had brought the check to plaintiff Bank because her husband wanted six of his creditors to be paid and had they taken the check to the bank where they normally did business, United National Bank in Canistota, the bank would "grab it."

Some time later that day, Mr. Eichinger received a telephone call from Mr. Clark Kepplinger who was the loan service director for United National Bank at that time. United National Bank is a secured creditor of Dean Tabke, with a security interest on the bulk of Tabke's property, including his accounts receivable. Mr. Kepplinger was aware of Compton's account with Tabke, and had gone to the Tabke residence on February 3, 1975, to insure that Compton's payment to Tabke would be applied against Tabke's line of credit with United Naitonal Bank in Canistota. Tabke informed Kepplinger that he had taken the proceeds of the Compton account to pay other creditors. This led Kepplinger to contact several area banks in hopes of determining where the check had been cashed. One of the banks Kepplinger contacted was plaintiff Bank where he spoke with Mr. Eichinger. In speaking with Eichinger, however, Kepplinger only asked whether the Tabkes had opened an account with his bank. When Eichinger indicated they had not, Kepplinger did not

pursue the matter any further. Upon failing to discover where the check had been cashed, Kepplinger contacted Compton's office, indicated that his bank held a security interest in the Tabke receivables, and ended the conversation, hoping that fear of the legal entanglements likely to ensue would induce Compton's office to stop payment on the check. A stop payment order was in fact issued by the defendants, and this lawsuit resulted.

Several other facts should be noted. The Tabkes normally banked at United National Bank in Canistota, and Mr. Eichinger was aware of this when he allowed Mrs. Tabke to cash the check at issue here. The United National Bank held a valid security interest which covered Tabke's accounts receivable, and this security interest had been perfected by filing in the office of the McCook County Register of Deeds. In addition, plaintiff McCook County National Bank subscribes to a commercial credit reporting service published by the McCook County Register of Deeds which reports the filing of financing statements in that office. The Tabke-United National Bank transaction had been reported in this service, and although it is not clear whether there was any awareness of the Tabke filing, Mr. Eichinger and other members of the plaintiff Bank's staff were familiar with this service. Finally, it should be pointed out that United National Bank defended this suit on behalf of defendants Compton and Godfrey.

The primary issue before the court is whether plaintiff McCook County National Bank became a holder in due course when Mrs. Tabke cashed the Compton check. Plaintiff does contend that, even if plaintiff is merely a "holder," defendants are liable for the amount of the check under S.D.C.L. section 57-12-20 (1967), since they admit the signature on the check is Compton's and Compton has not established a defense to the obligation of payment. As a mere holder, however, plaintiff Bank "takes the instrument subject to all valid claims to it on the part of any person; . . ." S.D.C.L. section 57-12-18(1) (1967). "All valid claims" in-

cludes "all liens, equities, or other claims of right against the instrument or its proceeds." Uniform Commercial Code Official Comment 2 to section 3-306. The claim of United National Bank to the check as proceeds of Tabke's accounts receivable, which were covered by a security agreement executed on May 8, 1974, is such a valid claim. Although United National Bank's claim is that of a third party to the check, it is available as a defense since United National Bank is defending this suit for Compton and Godfrey. S.D.C.L. section 57-12-18(4) (1967). Thus, if plaintiff Bank is merely a "holder" of the instrument in question, as opposed to a holder in due course, the instrument was taken subject to the claim of United Naitonal Bank. See Fulton National Bank v. Delco Corp., 128 Ga. App. 16, 195 S.E. 2d 455 (1973).

The real question, then, is whether McCook County National Bank took the check as a holder in due course as defined in S.D.C.L. section 57-12-2 (1967), which reads:

> A holder in due course is a holder who takes the instrument
> (1) For value; and
> (2) In good faith; and
> (3) Without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person.

If plaintiff was a holder in due course, it takes the instrument free of all defenses except those listed at S.D.C.L. section 57-12-17 (1967) — essentially fraud in the factum and discharge — none of which could be asserted by United National Bank or defendants Compton and Godfrey.

It is conceded that plaintiff Bank gave value for the instrument by issuing the six cashier's checks. Defendants assert, however, that plaintiff took the instrument with knowledge and in bad faith. Under the Uniform Commercial Code,

> "a person has notice of fact when
> (1) He has actual knowledge of it; or
> (2) He has received a notice or notification of it; or
> (3) From all the facts and circumstances known to him at the time in question he has reason to know it exists."

S.D.C.L. section 57-1-7 (1967). In addition, S.D.C.L. section 57-1-9 (1967) determines that notice to an organization is effective "from the time when it would have been brought to his (the person conducting the transaction) attention if the organization had exercised due diligence." Admittedly the mere filing of United National Bank's security interest with the McCook County Register of Deeds would not constitute notice of an adverse claim. See S.D.C.L. 57-12-14 (1967). Eichinger's familiarity with the credit reporting service maintained by the McCook County Register of Deeds, and the fact that the check obviously represented a payment on account with Tabke lead this court to believe that plaintiff Bank "had reason to know" of a secured creditor's claim to the check. See Morgan Guaranty Trust Co. of New York v. Third National Bank of Hampden County, 400 F. Supp. 383, 389-90 (D. Mass. 1975).

Thus, since all of the elements of S.D.C.L. section 57-12-2 (1967) must be present before one becomes a holder in due course, plaintiff was not a holder in due course. Although substantial questions as to plaintiff's good faith in cashing the check has been raised, the court finds it unnecessary to reach that issue in light of its previous finding regarding notice. Accordingly, judgment is entered for the defendants.

Done and entered at Sioux Falls, South Dakota, this 19th day of July, 1976.

BY THE COURT:

FRED J. NICHOL
Chief Judge

United States Court of Appeals

FOR THE EIGHTH CIRCUIT

No. 76-1785

McCook County National Bank,
a corporation,

Appellant,

v.

Bruce Compton and
D. W. Godfrey,

Appellees.

**APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF SOUTH DAKOTA**

Submitted: March 14, 1977

Filed: June 17, 1977

Before VAN OOSTERHOUT, Senior Circuit Judge, BRIGHT and ROSS, Circuit Judges.

ROSS, Circuit Judge.

This appeal arises from a civil action brought by the appellant, McCook County National Bank (McCook) to recover the amount of a check drawn on the account of appellee Compton, signed by appellee Godfrey, and cashed by McCook; but on which check Compton and Godfrey sub-

sequently stopped payment. The district court found that McCook was not a holder in due course and hence not entitled to recovery. For the reasons stated below, we reverse.

The check in question, drawn on the Northwestern National Bank of Sioux City, Iowa (Northwestern), for $13,340.00, was payable to Dean Tabke as payment for a cattle feeding contract between Tabke and Compton. The Tabke cattle feeding operation was financed by the United National Bank of Sioux Falls, South Dakota (United) which held perfected security interests in virtually all the property owned by Tabke. Financing statements were filed with the McCook County Register of Deeds to cover the property on September 6, 1973, September 15, 1973, and on May 9, 1974. Those security agreements were reported in the credit reporting service published by the Register of Deeds immediately following each filing. McCook bank subscribed to this service and Mr. Eichinger, the McCook bank officer involved in this transaction, was familiar with the service though he had no recollection of this specific report relating to Tabke.

After a particularly bad year for Tabke's business, a United bank officer, Kepplinger, met with Tabke on Thursday, January 30, 1975, to review his financial condition. United obtained at this time a complete list of Tabke's accounts receivable and decided to call in Tabke's loan. Tabke was instructed by Kepplinger to collect his accounts receivable and to turn any proceeds over to United and not to pay any general creditors. On Sunday, February 2, 1975, Tabke met with Godfrey, Compton's employee, and obtained a check for Tabke's contract with Compton. Inadvertently the check imprinter entered the amount $3,430.00 on the check though the handwritten portion stated $13,430.00. The check indicated that it was in full payment of feeding contract. Monday, February 3, 1975, Tabke endorsed the check "Dean Tabke, Beef Lodge" and instructed his wife to cash the check at McCook bank and obtain money orders made out to six creditors. The Tabkes did not have an account at McCook

bank but had done business with the McCook bank in the past.

Due to the discrepancy in the amounts inscribed on the check, Mrs. Tabke mentioned this problem to the McCook bank officer, Eichinger, when she went to the bank that morning to cash the check. Eichinger contacted Northwestern bank to verify the amount of the check and to ascertain whether sufficient funds existed to cover the check. Northwestern contacted Godfrey who acknowledged the error and said it was "okay to cash it." Northwestern then informed Eichinger that the check was "okay." Eichinger then approved the check and authorized the teller to cash it and issue the six money orders.

Before Mrs. Tabke left the bank she spoke with Eichinger again. The district court found the gist of Mrs. Tabke's remarks at that time to be that she had brought the check to the McCook bank because her husband wanted the six creditors to be paid and the United bank, where they normally did business, might "grab it [the check]." Mrs. Tabke then left the bank. The money orders were distributed to the creditors.

Kepplinger, from United bank, spoke with the Tabkes on February 3, 1975, and discovered that Tabke had paid other creditors with the proceeds of Compton's account. Kepplinger contacted Compton and explained United bank's interest in the Tabke accounts receivable. Though not directly asked by United Bank to stop payment on the check, Compton did so nevertheless. United bank has defended this suit on behalf of Compton and Godfrey.[1]

HOLDER IN DUE COURSE STATUS.

The issue before this court is whether McCook bank became a holder in due course of the Compton check when

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[1]McCook bank asserts that Compton and Godfrey are precluded from raising the claims of a third party to the instrument, namely, United bank. In light of our disposition of this case, we need not reach this issue.

Mrs. Tabke cashed it.[2] The pertinent South Dakota commercial statutes are as follows:

S.D.C.L. § 57-12-2 (1967)

> A holder in due course is a holder who takes the instrument
> (1) For value; and
> (2) In good faith; and
> (3) Without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person.

S.D.C.L. 57-1-7 (1967)

> In this title, unless the context otherwise requires, a person has "notice" of a fact when
> (1) He has actual knowledge of it; or
> (2) He has received a notice or notification of it; or
> (3) From all the facts and circumstances known to him at the time in question he has reason to know it exists.
>
> A person "knows" or has "knowledge" of a fact when he has actual knowledge of it. *** *The time and circumstances under which a notice or notification may cease to be effective are not determined by this title.* (Emphasis supplied.)

NOTICE.

In the district court's analysis of the transaction, the crucial factor was notice by means of the Register of Deeds reporting service. The district court found that McCook bank subscribed to that service and under S.D.C.L. 57-1-9 (1967) notice to an organization is effective "from the time when it would have been brought to his [the person conducting the transaction] attention if the organization had exercised due diligence." In addition, the district court found that Eichinger was personally familiar with both the service and the fact that "the check obviously represented a payment on

[2]Compton and Godfrey do not contend that McCook bank did not take the instrument for value. Accordingly that provision is not discussed.

account with Tabke." These factors led the district court to believe that McCook bank had reason to know of the secured creditor's claim and thus denied McCook bank status as a holder in due course, relying on *Morgan Guaranty Trust Co. of New York v. Third National Bank of Hampden County*, 400 F. Supp. 383 (D. Mass.1975). We disagree with the analysis of the district court for the following reasons.

In *Morgan*, Treasury Bills, stolen from Morgan Guaranty Trust Company (Morgan), were pledged to Third National Bank as security for loans. Morgan attempted to recover from Third National for the alleged conversion of those bills. Immediately after the bills were stolen, Morgan sent notices of the lost securities to bankers and brokers throughout the country including the Third National Bank. The court held that the receipt by Third National of the lost securities notice from Morgan and the fact that the exercise of due diligence would have brought the specific notice to the attention of bank personnel who handled such negotiable instruments placed Third National on notice and destroyed their status as holders in due course.

Such facts are not present in this case however. United bank did not give a specific notice to McCook bank of their security interest in Tabke's accounts receivable. Inclusion of Tabke's agreement in summary form in the general report in the Register of Deeds commercial reporting service is not the same as a *specific notice* sent *directly* to a bank from a secured party. Reliance on *Morgan* to support the effectiveness of notice under this factual situation is misplaced.

The question must be whether the reporting service involved here provided notice. This court declines to make any broad judgment concerning the effectiveness of notices in newspapers or reporting services: it is clear that under some circumstances, one would be hard-pressed to deny that an individual might have received notice from a newspaper account or report. However, in this case, the publication was a bi-weekly listing of security agreements that were filed with

the Register of Deeds. The listings appeared only once and covered only summaries of the *filings* of security agreements and made no mention of the disposition of those agreements at any later point in time. In addition, the three Tabke transactions appeared in the reporting service on September 15, 1973, September 30, 1973, and May 15, 1974, with the first and the last transactions covering proceeds from the secured collateral. These reports appeared, respectively, seventeen months, sixteen months and nine months prior to the time Tabke cashed Compton's check at McCook bank in February 1975. Assuming, *arguendo*, that subscribing to and receiving the reporting service was sufficient notice, it is questionable whether such notice remains effective. S.D.C.L. 57-1-7 (1967), *supra*, states that "[t]he time and circumstances under which a notice or notification may cease to be effective are not determined by this title." However, implicit in the inclusion of such a proviso in the statute is the logical inference that notice might cease to be effective after some period of time, an assertion embodied in the doctrine of "notice forgotten in good faith."

Graham v. White-Phillips Co., 296 U.S. 27 (1935) is the controlling case for this theory. *Graham* concerned a factual pattern quite similar to *Morgan Guaranty Trust Co., supra*, where notices that specific securities had been stolen were sent to area banks and brokers. The Court noted that "negotiable instrument law must be interpreted in view of the intended end — here, the free circulation of negotiable paper ***." 296 U.S. at 31. In light of that, the Court quoted from *Lord v. Wilkinson*, 56 Barb (N.Y.) 593 (1870):

> But if the *bona fides* of the defendants must be judged of from their acts, purposes and knowledge as they existed upon the day of the purchase, then the notice served is only *prima facie* or presumptive evidence of *mala fides*, and may be rebutted by proof that the notice was lost, or its existence and contents forgotten.

296 U.S. at 32.

That this doctrine is still vital is evidenced by the commentary to the corresponding Uniform Commercial Code provision 1-201(25) which states that by leaving open the time or circumstances under which notice or notification ceased to be effective, cases such as *Graham v. White-Phillips Co., supra*, are not overruled.

Indeed, in the First Circuit's disposition of *Morgan Guaranty Trust Company of New York v. Third National Bank of Hampden County*, 529 F.2d 1141 (1st Cir. 1976) this same issue was raised, but in the context of a specific notice received by the bank just *three* months prior to the negotiation of a very unusual security. The court stated however that:

> It is most likely that a notice will be deemed ineffective only because so much time has passed that the exercise of due diligence would not have brought the notice to the attention of the individual conducting the transaction.

529 F.2d at 1144.

In light of the nature of the incomplete factual description by the reporting service itself and the time sequence involved in this case, we can not agree that merely because the bank subscribed to the service they were on notice of the particular transaction reported therein, and to the extent that the district court so found we hold that factual finding to be clearly erroneous.[1]

Compton and Godfrey also assert that McCook bank had notice of an irregularity or defense to the instrument from the

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[1] Eichinger testified that at the time the check was cashed neither he nor any other representative of the McCook bank had any knowledge of the assignment of the account to United bank. No testimony was received to the contrary. Nothing in the record establishes that at the time of cashing the check, Eichinger remembered seeing the Tabke transactions in the commercial credit reports some nine to seventeen months earlier. To infer notice or bad faith under these circumstances, based on the earlier credit reports, is not tenable.

instrument itself, pointing out four irregularities: first, the check was drawn on a farm account, payable to Dean Tabke, Beef Lodge and obviously, therefore, a business check; second, the endorsement "In Final Settlement of Feeding Contract" also indicated that it was a business account; third, there was a $10,000 discrepancy on the face of it; and fourth, the check was presented already endorsed.

In regard to the fact that the check was already endorsed, we find this to be of no importance: it would not be so unusual for a spouse to handle such a transaction and in addition, McCook bank was familiar with both Dean Tabke and Mrs. Tabke. In regard to the $10,000 discrepancy, as will be discussed below, McCook bank prudently verified the correct amount before proceeding. We need only consider the assertion that the check was obviously a business check.

The endorsement here was not a restrictive endorsement nor was it endorsed by anyone other than the payee. Indeed, this check was endorsed by the payee and was fully negotiable on its face. Compton and Godfrey argue that the fact that the check appeared to be a fully negotiable *business* check was sufficient to alert McCook bank that this check represented secured proceeds and in addition, that Tabke had no right to disburse such proceeds to his creditors. We do not agree.

This is not a case of patent irregularity on the face of the instrument. For instance, in *First National Bank of Linton v. Otto Huber and Sons, Inc.*, 394 F.Supp. 1284, 1287 (D. S.D. 1975) a note was improperly executed leaving the due date of the note unclear. The court considered this irregularity sufficient to destroy holder in due course status. However in *Eldon's Super Fresh Stores, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 207 N.W. 2d 282 (Minn. 1973) an attorney used a check of a corporate client to buy stock for his personal account. Even though it was drawn on a corporate account, made payable to Merrill Lynch and signed by the corporate president, when it was negotiated by the corporate

attorney for a personal stock purchase, the court found that Merrill Lynch had no notice and was still a holder in due course. The court did not require Merrill Lynch to impute bad faith to the attorney who negotiated the check which is what Compton and Godfrey urge this court to do. We fail to find any notice from the instrument or duty to inquire further especially in view of our determination that the information in the report service nine to seventeen months earlier was insufficient to constitute the required notice. *See* Footnote 3, *supra.*

Compton and Godfrey finally assert that McCook bank had "notice" from the conversations at the bank between Eichinger and Mrs. Tabke on February 3, 1975. The district court found that after the check had been cashed, Mrs. Tabke again spoke with Mr. Eichinger and "made some remark to the effect that she had brought the check to plaintiff bank because her husband wanted six of his creditors to be paid and had they taken the check to the bank where they normally did business, United National Bank in Canistota, that bank would 'grab it.' " Though the testimony concerning this conversation is quite ambiguous, it is quite clear that this conversation occurred *after* the check had been cashed and is, in this court's opinion, irrelevant to the issue of notice. S.D.C.L. 57-12-15 (1967) states:

> To be effective notice must be received at such time and in such manner as to give a reasonable opportunity to act on it.

It seems logically impossible for a conversation which takes place *after* a check is cashed to provide effective notice of reasons why the check should not be cashed, thus enabling the bank to act on that knowledge.

Third National Bank In Nashville v. Hardi-Gardens Supply of Illinois, Inc., 380 F. Supp. 930, 941 (M.D. Tenn. 1974) stated that notice meant "notice at the time of the taking, the time of the negotiation of the note ***." Similarly, in *Manufacturers & Traders Trust Co. v. Murphy*, 369 F. Supp.

11, 13 (W.D. Pa. 1974) the maker of a check stopped payment on the check after it had already been negotiated for value at a second bank. The court found that the second bank became a holder in due course at the moment of negotiation and that later events made no difference in regard to its status. *See also Sullivan v. United Dealers Corp.*, 486 S.W. 2d 699, 701 (Ky, 1972). We find that the conversation between Eichinger and Mrs. Tabke subsequent to cashing the check provided no timely notice to McCook bank of any claims or defenses on the check.

GOOD FAITH.

In addition to the requirement that the instrument be taken without notice, S.D.C.L. 57-12-2(2) (1967) requires that the instrument be taken "[i]n good faith." Good faith is defined by S.D.C.L. 57-1-2(19) (1967) as "honesty in fact in the conduct or transaction concerned." *Central Bank & Trust Co. v. First Northwest Bank*, 332 F. Supp. 1166, 1169 (E.D. Mo. 1971) discussed the applicable standard:

> In determining whether the item was taken in "good faith" more than mere suspicion must be present; there msut be actual knowledge of some defect in the instrument. (Citations omitted.)

The district court declined to determine this issue but since it is a statutory requirement to show that a person claiming to be a holder in due course acted in good faith, this court must examine the record and judge the transaction not from hindsight but on the basis of the facts known to McCook bank at the time Compton's check was negotiated. We feel the record is clear that McCook bank had no actual or constructive knowledge that the check represented secure proceeds at the time it was presented. As stated in *Third National Bank In Nashville v. Hardi-Gardens Supply of Illinois, Inc., supra*, at 941, "[t]he fact that the Bank might have exercised better credit judgment with respect to the collateral is of no occasion." *See McConnico v. Third National Bank In Nashville*, 499 S.W. 2d 874, 882 (Tenn. 1973). *See* Footnote 3, *supra*.

McCook bank was presented with a check that had an obvious $10,000 discrepancy on its face. As any prudent bank would, McCook contacted the Northwestern bank to ascertain the correct amount and whether adequate funds existed to cover the check. Assured by the bank and indirectly by Compton, who issued the check, that the check was "okay," McCook proceeded to cash the check and issue money orders. There were no remaining irregularities in the instrument itself. Since this court has found no actual notice and insufficient constructive notice from the reporting service, and no other notice at the time the check was cashed, we can find no bad faith or dishonesty on the part of McCook bank in cashing the check.

In sum, while a better judgment concerning the negotiability of the check *might* have been made we can not find the requisite notice or bad faith that would deprive McCook bank of its status as holder in due course. Accordingly, the judgment of the district court is reversed and the case remanded for disposition not inconsistent with this opinion.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS,
EIGHTH CIRCUIT.